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November 19, 2003

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Board of Governors of the
Federal Reserve System
20th & Constitution Avenue, N.W.
Washington, D.C. 20551

Robert E. Feldman, Executive Secretary
Federal Deposit Insurance Corporation
550 17th Street, N.W.
Washington, D.C. 20429

Attention: Docket Nos. R-1156, R-1162

Attention: Comments/OES

Public Information Room
Office of the Comptroller of the Currency
Mailstop 1-5
250 E Street, S.W.
Washington, D.C. 20219

Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street, N.W.
Washington, D.C. 20552

Attention: Docket Nos. 03-21, 03-22

Attention: Nos. 2003-47, 2003-48

Re: Interim Capital Treatment of Consolidated Asset-Backed
Commercial Paper ("ABCP") Program Assets and
Notice of Proposed Rulemaking Regarding ABCP Programs
and Early Amortization Provisions

Ladies and Gentlemen:

Citigroup Inc. (hereinafter "Citigroup") welcomes the opportunity to comment on the interim final rule ("IFR") regarding the risk-based capital treatment for ABCP program assets and the notice of proposed rulemaking ("NPR") regarding ABCP programs and early amortization provisions, which were recently published by the Board of Governors of the Federal Reserve System (hereinafter "the Board"), the Federal Deposit Insurance Corporation (hereinafter "FDIC"), the Office of the Comptroller of the Currency (hereinafter "OCC") and the Office of Thrift Supervision (collectively hereinafter the "Agencies").

We applaud the Agencies for their efforts to quickly respond to the significant and inappropriate risk-based capital consequences deriving from the

implementation of Financial Accounting Standards Board Interpretation No. 46 (“FIN 46”), and the resulting requirement for the primary beneficiary to consolidate the assets of variable interest entities such as certain ABCP program vehicles. In addition, Citigroup supports the Agencies’ view that some regulatory capital should be held against liquidity facilities that are associated with ABCP programs and have an original maturity of one year or less, albeit at a much lower charge than that proposed in the NPR. Finally, while we generally endorse the direction the Agencies have proposed with respect to an early amortization capital charge for securitizations of retail credit exposures, we believe that any change in U.S. regulatory capital requirements should be delayed and coordinated with those finally adopted under the new Basel capital accord.

Specific comments with respect to the IFR and NPR are set forth below.

1. Interim Final Rule

While the interim final rule appropriately affords U.S. banking organizations at least temporary risk-based capital relief against ABCP program assets that would be consolidated under FIN 46, the Agencies’ regulations lack clarity and reflect an apparent inconsistency as to the nature of the commercial paper vehicles intended to be covered under the rule.

In particular, the Agencies have not uniformly defined an “asset-backed commercial paper program” in their respective proposals. We understand, however, that they intend for structured investment vehicles (“SIVs”) to be included within the scope of the definition of “ABCP programs” and therefore similarly eligible for immediate risk-based capital relief, despite certain of the Agencies having an ABCP program definition which is unclear and could be read to exclude SIVs. We believe that such inclusion is appropriate given that SIVs typically issue commercial paper to fund, in part, highly rated debt securities, are subject to prescribed rating agency requirements, and are conduits that present a similar risk profile to a banking organization acting as a sponsor or investor as any other ABCP program.

Accordingly, in order to avoid any possible future misinterpretations as to the types of vehicles contemplated by the IFR, we suggest that the Agencies remedy this seeming inconsistency by collectively adopting the following broader definition of an “asset-backed commercial paper program”:

An “asset-backed commercial paper program” means a commercial paper conduit, structured investment vehicle or other similar program that issues commercial paper backed by assets or other exposures held in a bankruptcy-remote special purpose entity.

2. Notice of Proposed Rulemaking

A. ABCP Programs – Treatment of Liquidity Facilities

The NPR attempts to distinguish between credit enhancements and liquidity facilities to ABCP programs, by defining an “eligible liquidity facility” as being one in which draws under the facility are subject to a reasonable asset quality test that precludes the funding of assets 60 days or more past due or in default. Further, the Agencies have also proposed that risk-based capital be held against eligible liquidity facilities having an original maturity of one year or less (so called short-term facilities) by requiring that such facilities be assessed a 20% credit conversion factor (a sizable increase over the 0% credit conversion factor currently permitted under the Agencies’ guidelines).

Citigroup opposes the imposition of a 20% credit conversion factor against short-term eligible liquidity facilities. Based upon historical experience, we believe that the credit risks underlying these facilities are remote and not sufficiently significant to warrant the mandating of such an excessive regulatory capital charge. Moreover, adoption of the proposed 20% credit conversion factor would create competitive inequities for U.S. banking organizations, not only with foreign competitors but also with domestic non-bank providers of corporate funding.

While we generally support the view that it is appropriate to maintain some regulatory capital against ABCP liquidity facilities having an original maturity of one year or less, we believe that a more risk sensitive and appropriately calibrated proxy for the credit risk truly inherent in these exposures should be adopted. Accordingly, Citigroup recommends that the Agencies revise their proposal and instead adopt a 5% - 10% credit conversion factor for such short-term liquidity facilities. Absent the greater refinement that an internal models approach would afford, a 5% - 10% credit conversion factor would nonetheless provide (as perhaps an interim measure) a much closer approximation of the extent of regulatory capital warranted for such facilities given their history of nominal credit losses.

Additionally, apart from the proper credit conversion factor to be applied to short-term ABCP liquidity facilities, we believe that defining an “eligible liquidity facility” by way of a static reasonable asset quality test (such as by assets 60 days or more past due or in default) is not appropriate, as this approach does not reflect either current market practices or a sensitivity to the differences in credit risk embedded in the assets or transactions underlying various ABCP programs. Conversely, we propose that the definition of eligible liquidity facilities be more flexible and incorporate reasonable asset quality tests that vary based upon the specific transaction structures or underlying asset types. For instance, it is conceivable that reasonable asset quality could be defined as being assets not more than 90 to 180 days past due or in default, with the determination being a function of specific structure and underlying asset types. Accordingly, in our view, the final rule should allow each banking organization to establish an asset and structure-specific reasonable asset quality test for assessing whether a facility is an “eligible liquidity facility”. Such an approach would more

accurately measure the banking organization's exposure, and thereby help to achieve the Agencies' goal of applying greater risk-sensitivity to the assignment of regulatory capital.

Finally, we urge that the Agencies consider revising the effective date of the NPR provisions related to ABCP liquidity facilities, so as to coordinate their timing with that of issuance of the new Basel capital accord. That is, it would seem most prudent to extend the date of implementation for these provisions (even if only for a calendar quarter to July 1, 2004), and thereby ensure consistency of treatment with the substance of the final Basel rules as well as avoid burdening U.S. banking organizations in their consideration of possible restructuring or repricing alternatives twice within a relatively short period of time.

B. Liquidity Facilities held in Trading Accounts

Citigroup understands and is sensitive to the Agencies' concern about potential risk-based capital arbitrage in response to the proposed increase in the credit conversion factor for short-term liquidity facilities associated with ABCP programs. The Agencies have addressed this concern through the following proposed amendments to their respective market risk capital rules:

“Liquidity facilities provided to asset-backed commercial paper programs in a bank's trading account are excluded from covered positions, and instead, are subject to the risk-based capital requirements as provided in appendix A of this part.” (OCC version)

“Covered positions exclude all positions in a banking organization's trading account that, in form or in substance, act as eligible liquidity facilities (as defined...) to asset-backed commercial paper programs (as defined...). Such excluded positions are subject to the risk-based capital requirements set forth in appendix A of this part.” (the Board and FDIC version)

We are very concerned that these proposed amendments would give rise to certain unintended consequences, as well as a new set of issues. For instance, there are structured derivative products related to various types of ABCP programs that may be classified as trading positions which are designed to provide customers with market price protection but which are not intended to achieve risk-based capital arbitrage.

First, we are concerned about establishing a precedent for the U.S. risk-based capital rules to ignore U.S. GAAP accounting decisions with respect to the Trading Book classification of individual transactions, by prohibiting application of the market risk capital rules and mandating use of the credit risk capital rules. Such a proposed approach effectively results in reclassifying the transaction to the Banking Book. Accordingly, this proposal would establish a dangerous precedent that would place U.S. banking organizations at risk of future piecemeal revisionism by the banking agencies,

potentially undermining business decisions related to other products carried in the Trading Book.

Second, there already exists a well-defined mechanism for assessing capital in the Trading Book. The market risk capital rules distinguish the capital (the specific risk component) required for liquid/rated vs. illiquid/unrated exposures held in the Trading Book. The specific risk component capital charge for an illiquid/unrated exposure is the same as under the credit risk rules, whereas rated exposures are appropriately analyzed in a more risk-sensitive calibration than under the credit risk rules. Additionally, the mark-to-market accounting discipline applied to trading positions (cash or synthetic), combined with individual banking organizations' market value adjustment process (the component that addresses illiquidity or pricing uncertainty), assures that capital is adequately reserved on a "real-time" basis. To not rely upon all of these regulatory and conventional mechanisms for assessing the appropriate amount of capital for market pricing risk, and instead to arbitrarily default to the credit risk rules, is not theoretically justified in practice or by the low-level of risk that providers assume via these derivatives, and could dissuade U.S. banking organizations from offering favorable products such as deep out-of-the-money liquidity options, which embody positive risk/return features.

Third, the NPR does not include a definition of "liquidity facilities" and certain agencies clearly indicate an intention to include "in form or in substance" arrangements (including derivatives) that are contracted with ABCP programs as "deemed" eligible liquidity facilities. Taken together, this creates a rule that is too broad and impractical to implement.

Fourth, the Agencies' working model for ABCP programs is too limited. Generally, it is focused on programs with underlying assets principally consisting of corporate trade receivables and other assets of corporate customers that are not rated by external credit rating agencies. Although the Agencies acknowledge that some programs may hold marketable assets such as rated asset-backed securities (ABS), they do not consider the impact if the programs hold rated corporate bonds. We are very concerned about the anomaly this will create: the Agencies' example would lead one to believe that a very small capital charge will result if the assets are highly rated when, in fact, a liquidity facility for a program whose underlying assets are AAA-rated corporate bonds would be assigned the highest credit risk weighting (i.e., the ratings-based approach cannot be applied currently to non-ABS corporate debt).

Finally, regulatory capital should be determined in the same way for the same risks in the Trading Book whether the transaction is a cash position (funded) or a derivative with a single counterparty or a CP issuer (unfunded). That is, there should not be drastically different U.S. regulatory capital results simply by indirectly assuming the same risks that could have been assumed directly. For instance, if the CP or the same type of underlying assets were held in the Trading Book, such positions would be subject to a VaR-based capital charge, whereas the proposed rule would result in a one-size-fits-all credit risk based (i.e., higher) capital charge for a synthetic position with the same

economic risks. It is not that we expect to achieve a zero regulatory capital charge in the Trading Book for these positions, but rather we believe it is inappropriate to take a full credit risk capital charge given that structural elements surrounding the transactions create remoteness as to potential risk of credit losses. We are looking to take a very conservative approach where capital is based on point of attachment (i.e., the point at which all subordination is exhausted) and risk assumed, and adjusted continuously to reflect changes in the market risk profile. This would be achieved by the mark-to-market, the trading book risk management and the market risk capital processes.

In conclusion, for the five reasons set forth above, we strongly urge the U.S. banking agencies to remove this prohibition against use of the market risk capital rules for derivatives and other similar arrangements with ABCP programs that are “deemed” eligible liquidity facilities, and that are held in the Trading Book under U.S. GAAP accounting.

Conversely, if the Agencies nevertheless choose to adopt the proposed amendment in some form, we respectfully submit that the exclusions from covered positions under the market risk capital rules be narrowed. Any amendment to the market risk capital rules should differentiate between (i) “plain vanilla” liquidity facilities traditionally associated with ABCP programs and (ii) trading products, so as to avoid hastily prescribing an unjustified credit risk capital treatment for all products.

We recommend that any such amendment incorporate the following guidance:

Liquidity facilities provided to asset-backed commercial paper programs in a bank’s trading account are excluded from covered positions, and instead, are subject to the risk-based capital requirements as set forth in [.....].

Trading products satisfying the following criteria will not be deemed to be liquidity facilities, but rather treated as covered positions in the Trading Book and subject to the market risk capital rules:

1. The arrangement with the ABCP program is documented in legal form as a derivative, is part of a documented trading strategy, is risk managed as a trading position and treated as a trading account transaction for U.S. GAAP accounting purposes (i.e., changes in value are marked to market through P&L and therefore reflected immediately in regulatory capital).
2. The purpose of the arrangement is to provide: (i) interest rate hedging; (ii) foreign exchange rate hedging; and/or (iii) market price protection on issued CP which entails funding solely due to remote price movements caused by a general disruption in the CP markets.
3. There is direct or indirect independent credit support in the overall arrangement. For example, sellers’ overcollateralization, third-party financial guarantees, subordinated tranches held outside the ABCP program, credit derivatives, or other arrangements.

4. The underlying assets and/or the related liabilities (i.e., the CP) would be eligible for inclusion in the Trading Book.

C. Early Amortization Capital Charge

Citigroup commends the Agencies' efforts to adopt a more risk-sensitive tiered approach to assessing regulatory capital against the potential risks arising from early amortization features which may be present in securitizations of retail credit exposures. Such an approach is vastly improved over that which had been suggested by the Agencies in the past, and reflects a more refined calibration of potential risks and related regulatory capital charges.

Although we generally favor the direction the Agencies have taken in the NPR on this critically important issue, we strongly encourage that any changes to the U.S. risk-based capital rules for an early amortization capital charge be delayed and coordinated with those requirements (both as to nature and timing) ultimately adopted under the new Basel capital framework. The risk of inconsistent or contradictory guidance in this regard is much too great, and the effects too far reaching, to justify the adoption of revised U.S. regulatory capital requirements in advance of the implementation of the new accord. Furthermore, we do not understand the urgency to impose incremental risk-based capital charges against any early amortization features in retail credit securitizations, given that these structures generally are assessed regulatory capital currently under the Agencies' securitization and recourse rules.

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Thank you in advance for your consideration of the views expressed herein. In addition, we greatly appreciate the speed and direction with which the Agencies have responded to the significant risk-based capital implications arising from the adoption of FIN 46.

We would welcome the opportunity to meet with you in person, should that be desirable. Alternatively, if you have any questions, please contact me at (212) 559-9392.

Sincerely,

Grace B. Vogel
Deputy Controller – Citigroup Inc.

cc: Norah Barger
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